NO. 83-1024

In The

Supreme Court of the United States

October Term, 1983

Trio Manufacturing Company,
Petitioner,

vs.

United States of America,
Respondent.

On Certiorari To The United States Court of Appeals For The Eleventh Circuit

SUPPLEMENTAL APPENDIX

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES OF AMERICA, and DOUGLAS P. McCALLUM, Special Agent, Internal Revenue Service,	)	No. C82-1138 & C82-1139
Petitioners,	)	
vs.	)	ORDER FOR SERVICE OF REPORT AND RECOMMENDATION OF UNITED STATES MAGISTRATE
GEORGE B. PENNINGTON, CPA,	)	
Respondent,	)	
WILLIS H. NEWTON, LEE M. NEWTON and TRIO MANUFACTURING COMPANY,	)	
Intervenors	)	

Attached is the report and recommendation of the United States Magistrate made in this action in accordance with 28 U.S.C. § 636(b)(1) and this Court's Local Rule 290. Let

the same be filed and a copy, together with a copy of this Order, be served upon counsel for the parties.

Pursuant to 28 U.S.C. § 636(b)(1), each party may file written objections, if any, to the report and recommendation within ten (10) days of the receipt of this Order. Should objections be filed, they shall specify with particularity the alleged error or errors made (including reference by page number to the transcript if applicable) and shall be served upon the opposing party. The party filing objections will be responsible for obtaining and filing the transcript of any evidentiary hearing for review by the District Court. If no objections are filed, the report and recommendation may be adopted as the

Opinion and Order of the District Court and any appellate review of factual findings will be limited to a plain error review. See Nettles v. Wainwright, ___ F.2d ___ Slip op. p. 15152 (5th Cir. 1982) (Unit B en banc).

The Clerk is directed to submit the report and recommendation with objections, if any, to the District Court after expiration of the above time period.

AND IT IS SO ORDERED this 27th day of July, 1982.

Signed/Robert J. Castellani
UNITED STATES MAGISTRATE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES OF AMERICA, and DOUGLAS P. McCALLUM, Special Agent, Internal Revenue Service,	)	No. C82-1138A & C82-1139A
Petitioners,	)	
vs.	)	
GEORGE B. PENNINGTON, CPA,	)	
Respondent,	)	
WILLIS H. NEWTON, LEE M. NEWTON and TRIO MANUFACTURING COMPANY,	)	
Intervenors	)	

MAGISTRATE'S REPORT AND RECOMMENDATION

These two cases are before the magistrate on the petitions to judicially enforce Internal Revenue summonses pursuant to 26 U.S.C.

§ § 7402(b) 7604(a). The two cases are hereby consolidated under rule 42(a), F.R.Civ.P. Pursuant to notice a consolidated adversary hearing was held on June 29, 1982. After considering the evidence submitted at that hearing and the legal arguments of petitioners and intervenors, the magistrate recommends the following findings of fact and conclusions of law.

Findings of Fact

1. On April 7, 1981, petitioners (hereafter IRS) served two summonses upon respondent directing him to testify and produce certain books, records and other data described in the summonses. Petitioner Douglas P. McCallum is a Special Agent employed by the IRS and is authorized to issue Internal Revenue

summonses. The respondent is a certified public accountant. Intervenors are Willis H. Newton, Lee M. Newton and Trio Manufacturing Company (hereafter taxpayers). The summoned documents related to the income tax liability of taxpayers for the years 1977, 1978 and 1979.

2. Taxpayers stayed compliance with the summonses pursuant to 26 U.S.C. §7609(b) and respondent has not complied with the summons.

3. The IRS is examining the taxpayers to determine whether they have any additional tax liability for the years in question and whether they have violated the criminal law relating to payment of tax.

4. During his investigation of the corporate taxpayer, Revenue Agent Misinco [1], on or about December 10, 1980, discovered several invoices or paid expense invoices that appeared to be altered. Although his discovery made him suspicious and caused him to investigate further, he did not obtain a firm indication of fraud until approximately January 23, 1981. Within approximately 45 days after his initial discovery, and after conversations with his supervisor and further review of the

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[1] A revenue agent only determines civil tax liability whereas a special agent also investigates the possibility of recommending criminal charges against the taxpayer. United States v. Toussaint, 456 F. Supp. 1069 (S.D.Tex. 1978).

corporate taxpayer's records, Revenue Agent Misinco decided on or about January 23, 1981, to submit the case for referral to IRS Criminal Investigation Division as a possible criminal fraud case. The case was accepted for referral shortly thereafter.

5. The case's current status is a joint criminal and civil investigation. The special agent in charge of the investigation has not yet decided whether to initiate a referral of the case to the Department of Justice for criminal prosecution. According to his testimony, he cannot make this decision until he has reviewed the data and testimony sought by this summons. The only contact by the special agent or his supervisor with the Department of

Justice about this case concern this request for summons enforcement. No official of the IRS has decided whether to refer this case to the Department of Justice for criminal prosecution.

6. Although the IRS has seen certain documents and data which were in the taxpayers' possession, it has not reviewed or copied any of the requested documents in respondent's possession or heard the testimony of the respondent in this case.

7. All administrative steps required by the Internal Revenue Code for issuance of the summonses have been taken.

Conclusions of Law

8. This court has jurisdiction of this matter under 26 U.S.C. § § 7402, 7604.

9. Taxpayers have intervened timely and are proper parties to this proceeding.

10. The IRS need not meet any standard of probable cause to obtain enforcement of its summonses. It need only make a preliminary showing

> that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the code have been follows. . . .

United States v. Powell, 379 U.S. 48, 57-58 (1964), quoted with approval in United States v. Southeast First National Bank, 655 F.2d 661, 664 (5th Cir. 1981).

11. The IRS can make this prima facie case for enforcement by introducing the sworn affidavit of the agent who issued the summons. United States v. Southeast First National Bank, 655 F.2d 661, 664 (5th Cir. 1981). Once the IRS makes this minimal showing, the burden shifts to the taxpayer to come forward with rebutting evidence. Id.

12. The summonses here were not issued solely to gather information for a criminal investigation. The Supreme Court and the Fifth Circuit Court of Appeals have decided that a summons issued before the IRS makes a formal recommendation of criminal prosecution to the Department of Justice is invalid only if the IRS has abandoned, in an institutional sense, the pursuit of

immediate civil tax collection. United States v. LaSalle National Bank, 437 U.S. 298 (1978); United States v. Davis, 636 F.2d 1028 (5th Cir. 1981); United States v. Harris, 628 F.2d 875 (5th Cir. 1980). Since the decision to refer usually takes place in the upper echelons of the IRS hierarchy after several layers of review, such an institutional abandonment would require an extraordinary departure from established procedures. United States v. LaSalle National Bank, supra, 437 U.S. at 314. The Fifth Circuit Court of Appeals has therefore recognized that before the investigating agent completes his investigation or makes a recommendation for criminal prosecution, summonses are "virtually unassailable".

United States v. Harris, 628 F.2d 875, 882 (5th Cir. 1980). The taxpayers have introduced no evidence which could overcome their high hurdle on this issue.

13. The information sought is not already within the IRS' possession. One of the primary reasons for seeking this information from respondent is the taxpayers' suspected fraud. The IRS admits it has seen some information comparable to that requested when it reviewed the taxpayers' records. But, the IRS makes a very persuasive argument that it wishes to verify the accuracy of the data by comparing what it has already seen to what the taxpayers furnished to their accountant. The IRS need not prove probable cause before it investigates a taxpayer. It can seek

information merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. United States v. Wyatt, 637 F.2d 293, 299 fn. 9 (5th Cir. 1981).

Further, much of what the IRS seeks from the respondent is not in IRS' possession. Also, it has not received or reviewed any information from the respondent. No one has claimed that the possibly duplicative material is bulky or burdensome to produce. The "already possessed" rule is better suited for cases such as United States v. Pritchard, 438 F.2d 969 (5th Cir. 1971), where an agent had informally examined the taxpayer's records at length and later sought to compel their production without any explanation of why the

informal examination was insufficient. See United States v. Davis, 636 F.2d 1028, 1038 (5th Cir. 1981).

14. The test of relevancy in a summons enforcement case is whether the summons seeks information which might throw light on the correctness of the taxpayer's return. United States v. Wyatt, 637 F.2d 293 (5th Cir. 1981). In this case, the relevancy of the requested documents is abundantly clear from the description of the documents in the summonses.

15. The IRS did not fail to follow the administrative steps necessary to secure enforcement of the summonses. As noted in finding of fact 4 above, the magistrate believes that the revenue agent referred the

investigation to IRS Criminal Investigation Division when he had assured himself he had sufficient indications of fraud. In any event, the magistrate doubts that the defect asserted by taxpayers, even if proved, would invalidate the summonses. See United States v. Bank of Moulton, 614 F.2d 1063, 1066 (5th Cir. 1980); United States v. Lockyer, 448 F.2d 417 (10th Cir. 1971).

16. The summons is not overbroad. United States v. Wyatt, 637 F.2d 293 (5th Cir. 1981).

RECOMMENDATION

Taxpayers have filed motions for discovery of materials beyond those already produced at the adversary hearing. At that hearing taxpayers

failed to raise any colorable question as to the good faith of the IRS in this proceeding. Any further discovery would be a waste of time and an unnecessary delay to the enforcement of the summonses. United States v. Davis, 636 F.2d 1028, 1038, (5th Cir. 1981). the magistrate recommends that any further discovery be denied.

For the above reasons, the magistrate recommends that the summonses be enforced as provided by law. The respondent should be required to testify and produce the designated records before Special Agent McCallum or any other proper officer of the Internal Revenue Service within fifteen (15) days after the entry of any order approving this report and recommendation, at a

reasonable time and place to be determined by Special AGent McCallum or any other proper officer. The magistrate further recommends that petitioners recover from intervenors-taxpayers their costs in bringing these actions.

SO RECOMMENDED this 27th day of July, 1982.

Signed/Robert J. Castellani
ROBERT J. CASTELLANI
UNITED STATES MAGISTRATE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES OF AMERICA, and DOUGLAS P. McCALLUM, SPECIAL AGENT, INTERNAL REVENUE SERVICE,	)	CIVIL ACTION NOs.: C82-1138 A & C82-1139
Petitioners,	)	
vs.	)	
GEORGE B. PENNINGTON, CPA,	)	
Respondent.	)	

O R D E R

After having carefully reviewed the record, the transcript and the Magistrate's Report and Recommendation in this case, the Magistrate's report and Recommendation is received with approval and adopted as the opinion and order of the court.

So ORDERED this 31st day of August, 1982.

Signed/Robert H. Hall
ROBERT H. HALL
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

UNITED STATES OF AMERICA, and DOUGLAS P. McCALLUM, Special Agent, Internal Revenue Service,	)	CIVIL ACTION NO. C82-1133A
Petitioners,	)	
vs.	)	CIVIL ACTION NO. C82-1139A
GEORGE B. PENNINGTON, CPA,	)	
Respondent.	)	
In the matter of the Tax Liability of Willis H. Newton, Lee M. Newton and Trio Manufacturing Company.	)	

O R D E R

Petitioners filed a motion for contempt against Respondent, George B. Pennington, to require him to show cause why he should not be held in contempt of

this court's order of September 23, 1982 enforcing two Internal Revenue Service summonses. That order was appealed to the Eleventh Circuit Court of Appeals. Both courts initially denied a stay of this court's order, but on October 7, 1982, on motion for reconsideration, the Eleventh Circuit entered a stay ". . . with respect to tax accrual workpapers within the doctrine of United States v. Young, 677 F.2d 211 (2d Cir. 1982)." On further consideration, the Eleventh Circuit made no change in its October 7 order.

The documents sought by Petitioners in the motion for contempt consist of twenty-one (21) pages. These documents have been submitted to the court for an in camera inspection.

Petitoners contend that the taxpayer, Trio Manufacturing Company, is a closely-held family corporation and therefore does not fall within the doctrine of United States v. Young, supra. This argument has considerable merit since the papers in question in Young were prepared for a public corporation required by the federal securities laws to file a financial statement of its potential liabilities. The limited privilege for the accountant's tax accrual workpapers recognized in Young seems to have been born from the collision the court perceived between the interest in the collection of revenues and the promotion of full disclosure under the securities laws.

However, the court must reject the argument that the Young privilege does not apply to a company not subject to the disclosure requirements of the federal securities laws. If the Eleventh Circuit believed Young to be inapplicable or even altogether unwise, there would have been no reason to have entered a stay. At the very least, the Eleventh Circuit apparently felt a stay was necessary to protect the taxpayer until it could thoroughly examine the doctrine of Young. In these circumstances, and without clearer direction from the court above, this court must assume Young applies for purposes of determining what papers are subject to the stay.

The government argues alternatively that even if Young applies, the papers in question here are not tax accrual workpapers because none of the financial statements of Trio Manufacturing Company disclose contingent tax liabilities. Tax accrual workpapers reflecting subjective discussions and opinions concerning contingent tax liabilities, the government argues, cannot exist in the absence of such a contingency.

Even though this argument has considerable merit as well, this court cannot accept it in view of the definition of tax accrual workpapers set out in Young. That court stated that "[t]hese documents are generated when an auditor verifies whether the taxpayer

has accurately determined its contingent tax liability." 677 F.2d at 217. It seems to this court that the same process would take place and papers reflecting subjective impressions generated when the conclusion is that there is no contingent tax liability as when a contingency is determined to exist. Young, in any event, indicates no such distinction.

With the above premises established, the court finds that the twenty-one pages are tax accrual workpapers prepared by an independent auditor in verifying whether the taxpayer has accurately determined its contingent tax liability. They therefore come within the stay granted by the Court of Appeals. The

Petitioners' motion for contempt against the Respondent is DENIED.

So ORDERED this 19th day of November, 1982

Signed/Robert H. Hall
ROBERT H. HALL
UNITED STATES DISTRICT JUDGE

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